## CAPITAL PROJECTS AND BOND OVERSIGHT COMMITTEE

## **Minutes**

## May 14, 2008

The Capital Projects and Bond Oversight Committee met on Wednesday, May 14, 2008, at 1:00 PM, in Room 171 of the Capitol Annex. Senator Elizabeth Tori, Chair, called the meeting to order.

Present were:

<u>Members:</u> Senator Elizabeth Tori, Co-Chair; Representative Mike Denham, Co-Chair; Senator Dan Seum; and Representatives Robert Damron, Steven Rudy, and Jim Wayne.

Guests testifying before the Committee: John Osborne, Western Kentucky University; John Hicks, Governor's Office for Policy and Management; Ken Marks and Nancy Brownlee, Finance and Administration Cabinet; David Leddy, Department of Vehicle Enforcement; John Covington and Sandy Williams, Kentucky Infrastructure Authority; Katie Smith, Economic Development Cabinet; Tom Howard and Terri Fugate, Office of Financial Management; and Marc Mathews, University of Kentucky.

<u>LRC Staff:</u> Nancy Osborne, Shawn Bowen, Kristi Culpepper, Pat Ingram, Don Mullis, and Lesa Prewitt.

Senator Tori asked Nancy Osborne, Committee Staff Administrator, to review the correspondence and information items. Ms. Osborne said correspondence items included two letters relating to the issuance of Kentucky Economic Development Finance Authority (KEDFA) Louisville Arena Project Revenue Bonds. The April 15 letter from the Committee to the Finance Secretary communicated the Committee's decision not to approve the bond issue. The April 16 letter from the Finance Secretary to the Committee stated the Cabinet's intent to proceed with the bond issue. She also noted that according to a May 13, 2008 Louisville *Courier-Journal* article, Assured Guaranty would be the bond insurer and the bonds were projected to be sold in June. The sale would include \$280 million in variable rate bonds and an interest rate swap.

The second item of correspondence was from the University of Kentucky reporting the purchase of scientific research equipment at a cost of \$506,160 (\$256,117 from university restricted funds and \$250,043 from state New Economy grant funds). The equipment, known as a FACSAria II flow cytometer, will be purchased for use by staff of the Markey Cancer Center.

Ms. Osborne then briefly reviewed various items in the monthly Staff Update including news that the Kentucky Higher Education Student Loan Corporation (KHESLC) has suspended loans for first-time borrowers effective May 1, 2008. Also, the City of Highland Heights (City) and Northern Kentucky University (NKU) have reached an agreement on the City's annexation of the NKU campus. The City will gain approximately \$800,000 in new payroll taxes from the university's employees and in return will transfer seven acres on John's Hill Road to NKU and provide funds over the next 20 years to NKU to build a soccer complex.

The Staff Update noted a report from the State Auditor of Public Accounts that the Kentucky state park system is losing money at an increasing rate despite significant state-funded capital improvements made since 1994. Another item mentioned was that the Central Kentucky Riding for the Handicapped, located at the Horse Park, still needs funds to complete planned facilities reported to the Committee in August 2003. Groundbreaking ceremonies for a new community center at E.P. "Tom" Sawyer State Park, financed by \$1 million from the 2006-08 Parks Development Pool and a \$1 million private donation, was held April 18, 2008.

The next information item updated the Committee on the Franklin Circuit Court's recent ruling on the prevailing wage lawsuit regarding state park projects and similarly situated state projects. In April and May 2007, a series of Request for Proposals (RFP) were issued for private development at several state parks (General Burnside, Green River, Lake Malone, and Lake Herrington). According to the RFPs, state funds from the 2006-08 Parks Development Pool were offered for associated infrastructure development; however, if the private developer accepted such funds, the state's prevailing wage laws would apply to the entire project. In April 2007, the state Department of Labor had issued an opinion that if no state funds were involved in these private developments on state property, prevailing wage laws would not apply. On September 28, the AFL/CIO filed suit against the Finance Cabinet seeking a court directive that for these projects requested by the RFPs and for all similar projects built on state property, a private developer must pay prevailing wage rates.

In March 2008, the Franklin Circuit Court ruled that these specific park projects and similar projects "constitute public works subject to the Kentucky prevailing wage laws." The court directed the Finance Cabinet to abide by the Department of Labor's February 2008 legal opinion, which analyzed and amended the April 2007 opinion, and concluded that a ground lease arrangement qualifies as a contract for construction with a public authority. The ruling cited the extensive state control during development, construction, and operation of the improvements, and the fact that title to the improvements would pass to the state upon expiration of the underlying ground lease. The court's order and judgment, and the Department of Labor's 2008 opinion that was incorporated into the order, were included in the meeting materials.

Ms. Osborne said the next information item was a copy of the April 16, 2008 letter from the Finance Cabinet to the developer of the proposed Kentucky Horse Park Hotel project notifying the developer that the project was terminated for default for failure to meet conditions set forth in correspondence dated February 29. The conditions included a requirement that by April 15, the Finance Cabinet must receive a written confirmation that the bonds financing the project have been committed for sale.

Also included in members' folders was a listing of legislation enacted during the 2008 Regular Session that relates to the jurisdiction of the Committee and the updated debt issuance calendar.

Representative Wayne said it would seem that the Franklin Circuit Court's ruling on prevailing wage would also apply to all public university projects. He asked if this information has been disseminated to public universities in the state and to the community and technical college system. Sherron Jackson, Assistant Vice President, Finance and Equal Employment Opportunity, Council on Postsecondary Education (CPE), said a copy of the ruling has not been sent to the universities but CPE has communicated with staff a willingness to disseminate that information following this meeting.

Representative Wayne said this information could be helpful to the universities in terms of clarifying the application of the prevailing wage law to projects built on state property.

Noting that a quorum was present, Senator Tori asked the secretary to call the roll.

Representative Wayne made a motion to approve the minutes of the April 15, 2008, meeting. The motion was seconded by Senator Seum and approved by voice vote.

Senator Tori asked Mr. John Osborne, Vice President for Campus Services and Facilities, Western Kentucky University (WKU), to discuss a project report for the university.

Mr. Osborne said WKU would like to initiate a project to add club seating to Diddle Arena. The project would add approximately 142 additional seats to the arena and generate an additional \$213,000 in annual revenues. The cost of the project is \$773,000 and will be paid by the WKU Hilltopper Athletic Association.

Mr. Osborne said the premium seating area will include standing / sitting areas, food and beverage stations, and wide screen television monitors. He said the improvements would be to a state-owned facility. All maintenance and operational expenses associated with this addition would be the responsibility of the WKU athletic

department. The schedule for the project calls for it to be completed in time for the upcoming season in October or November of this year.

Senator Tori said unbudgeted projects for which a university seeks approval are typically approved by the university's governing board prior to being submitted to CPE or the Committee. She asked why WKU's governing board did not review and approve this unbudgeted project in the normal sequence. Mr. Osborne said in this particular case, the athletic department did not present the project to the WKU administration until recently. The project became viable with the success of the WKU basketball team in the recent NCAA post-season tournament that spurred increased fundraising. Mr. Osborne said the President did not seek approval from the WKU Board of Regents for an unbudgeted project to be financed by private funds prior to initiation of the project. However, this project will be submitted to the Board of Regents for affirmation at its June meeting. He added that the timing of the project's submission is also due to the aggressive schedule for completion.

Representative Wayne said if he was a board member he might be insulted that a project was being initiated before the board had approved it. Mr. Osborne explained that there is not going to be any expenditure of funds or any activity to cause any expense prior to the project being presenting to the board in June.

Representative Wayne said the university board governs the university, not the President, the athletic foundation, or the athletic department. He said he did not think this was the appropriate decision-making model for approval of university capital projects that are not authorized by the General Assembly, and he was confused as to why the board would agree to such a process.

Senator Seum asked if the university's board had the power to veto the project. Mr. Osborne responded affirmatively. Mr. Osborne added that when they have a foundation working with the university to make an improvement that will benefit everyone, as this project will, it is a win-win situation for everyone. He said this was a project that was not considered a viable project a few months ago, and could now be an improvement to the arena being updated in a section that presently is vacant. It will add additional seating and generate new revenue for the university.

Representative Damron said he has introduced legislation for the past four years to provide flexibility to universities to make decisions and each time his proposals have met resistance. He said it concerns him that the administration or the athletic association at WKU would assume that they have the authority to initiate capital projects on their own without going through the proper process. He said he wondered if university officials wanted to build new projects without respect for process and oversight.

In response to a question from Representative Damron, Committee staff affirmed that proposed legislation relating to postsecondary debt would have required prior certification by a university's governing board and a report to the Committee, CPE, and the Finance Cabinet before debt could be issued. Committee staff also clarified that CPE did approve this Diddle Arena project at its May 9 meeting.

Representative Damron said the process by which this unbudgeted project is being approved is akin to putting the cart before the horse. He said he would vote for it since the approval was contingent upon approval from the WKU Board of Regents. He said it is not good public policy to go around the Board of Regents because it is statutorily the policy setting body for the university. Unbudgeted projects, regardless of fund source, should be approved according to the proper process.

Senator Tori said she agreed with the comments that have been made by other members.

Representative Denham made a motion to approve the project contingent upon approval by the WKU Board of Regents at its June 27, 2008, meeting. The motion was seconded by Representative Wayne and approved by unanimous roll call vote.

Representative Wayne made a motion that the co-chairs write a letter advising CPE that the Committee requests the Council not approve projects of this nature without prior approval by the respective university's governing board. The motion was seconded by Representative Damron and passed by voice vote.

Senator Tori next asked John Hicks, Deputy Budget Director, Governor's Office for Policy and Management (GOPM), and Ken Marks, Deputy Commissioner, Department for Facilities and Support Services, to present the monthly project report submitted by the Finance and Administration Cabinet.

Mr. Hicks first reported an unbudgeted project for the Justice and Public Safety Cabinet to purchase a Mobile Command Center at a cost of \$333,000. The funding sources include a \$266,400 federal grant from the Motor Carrier Safety Administration and \$66,600 from agency restricted funds. According to the materials submitted to the Committee, the Mobile Command Center will be used by the Department of Vehicle Enforcement staff to transmit on-site information during natural disasters and other critical events.

In response to a question from Representative Damron, David Leddy, Deputy Commissioner, Department of Vehicle Enforcement, said the Mobile Command Center would be used when the Department conducts weight and inspection details at various locations away from the weigh facilities throughout the state. The Department identified

the need for this several years ago, especially to deal with coal trucks in Eastern Kentucky.

Representative Damron asked if the only purpose for the Mobile Command Center was to enforce the Department's mission of enforcing requirements on commercial truck traffic. Mr. Leddy said yes, that is the day-to-day purpose.

Representative Damron asked if the Command Center would be used by officers to set-up speed traps for four-wheelers or to write tickets for DUI's. Mr. Leddy said it would not be used for these purposes. He said it will be available to the Commonwealth in times of disasters and emergencies if the need for existing command centers is exceeded and will be equipped with radios to communicate with any department within the Commonwealth. It will be a back-up asset in these situations.

Representative Damron said he would vote for the project if it was going to be used for the stated mission. He said he had cast his last vote to allow motor vehicle enforcement officers to act as police officers. Mr. Leddy said the project was about inspecting and weighing trucks. Representative Damron said that is what the Department should be doing but the officers were not doing this. He said if the administration cannot address this, a bill would be filed in 2009 to address it.

Representative Damron made a motion to approve the project. The motion was seconded by Representative Rudy and passed by unanimous roll call vote.

The next report Mr. Hicks presented was a federally funded scope increase of \$166,000 for the Department of Military Affairs, Bluegrass Station Helipad and Taxiway Expansion to construct two helipads and add 1,400 feet of taxiway at Bluegrass Station in Fayette County. The project's purpose is to ensure safety for Special Operations Forces Support Activities (SOFSA), a defense contractor and one of Bluegrass Station's major tenants, which is responsible for the repair of helicopters used by Special Forces in foreign conflicts.

Mr. Hicks said this unbudgeted project was reported to the Committee in November 2007 at a scope of \$1,498,000 (federal funds). The design phase is complete, and the scope increase is needed to accept the low bid for construction. He said the Department and the Finance Cabinet consulted with SOFSA to come up with the additional federal funds to adequately fund the low bid.

In response to questions from Representative Wayne as to how the contracts for design services and for construction services were awarded, Mr. Marks said the bid process for the project was not advertised to the public because they were procured through the emergency procurement process.

Mr. Marks said the Finance Cabinet contacted two different consultants for the design work. The first consultant declined the offer, and the second consultant was selected. He said a contract was negotiated with Entran Engineers of Lexington in February. Five construction firms were invited to bid on the construction contract, and three firms submitted quotes.

Representative Wayne asked why this project was considered an emergency. Mr. Hicks said the genesis for the need of an emergency procurement came from the Department of Defense to get this project completed so they could safely continue the modifications for the aviation equipment. The Adjutant General requested and the Finance Cabinet Secretary approved the use of the emergency procurement process in January 2008.

Representative Wayne asked if procuring contract services in this manner opens up the process for abuse. Mr. Marks said the emergency procurement process had been approved for this project. The bids received were within range of one another, which represents a competitive situation.

Representative Wayne said if he were a contractor and did not get invited to bid, he would not feel that is was a competitive environment. He said the state is being dictated to by the federal Department of Defense, but he wondered who is questioning the federal agency. He said that agency has made a lot of mistakes recently, and he was not sure if this project justified circumventing proper procurement procedures.

Senator Seum asked if it is allowable to circumvent the procurement process if a project is 100% federally funded. Mr. Hicks said circumvention of the procurement process is not permitted, regardless of the fund source. However, the emergency procurement process is a statutorily available process once decided upon by the Secretary of Finance.

Representative Damron made a motion to approve the project. The motion was seconded by Representative Rudy and passed by roll call vote with one member voting "No."

The last items Mr. Hicks reported were two stream restoration projects funded with moneys from the Fees-in-Lieu of Stream Mitigation Projects Pool. The first project, Sand Lick Creek - Powell County, was an allocation of \$1,860,000 for restoration and enhancement of 12,850 feet of Sand Lick Creek in the Daniel Boone National Forest. The second project was a request for a \$125,000 scope increase for the Brushy Creek - Greenup County project to repair damage from a storm to a previously restored bank. The revised project scope is \$925,000. No action is required by the Committee for allocation of these pool funds.

Nancy Brownlee, Director, Division of Real Properties, reported nine state agency lease modifications that involved square footage increases or decreases for the months of January through March 2008. Each of the modifications was less than \$50,000 and did not require Committee approval.

Senator Tori next asked John Covington and Sandy Williams, Kentucky Infrastructure Authority (KIA), to come to the table. Ms. Williams presented five KIA Fund A (Federally-Assisted Wastewater Revolving Loan Fund) loans for the Committee's approval. The first loan was for \$43,307,280 for the City of Bowling Green in Warren County. The loan is the single source of funding for this project, and will be used to upgrade and expand Bowling Green Municipal Utilities' wastewater treatment plant from 10.6 million gallon per day (MGD) to 15 MGD. The loan has a 20-year term and a 1.0% interest rate.

The next loan Ms. Williams presented was for \$50,000,000 for Sanitation District No. 1 (SD1) in Boone, Kenton, and Campbell Counties. The loan proceeds will be used to assist in funding a \$83,147,554 project to construct a new 20 MGD wastewater treatment plant to serve the western regional service area. The loan will have an interest rate of 1.0% for 20 years. Construction of the plant complies with the consent decree between SD1, the US Environmental Protection Cabinet, the Kentucky Environmental and Public Protection Cabinet, and the US Department of Justice to address sewage overflows in the region.

The third Fund A loan Ms. Williams presented was for \$21,192,000 for the City of Elizabethtown in Hardin County. The funds will be used to upgrade and expand the City's wastewater treatment plant from 7.2 MGD to 13 MGD. The loan is the sole source of funding for the project. The loan has a 20-year term and a 3.0% interest rate.

The fourth loan Ms. Williams presented was for \$8,477,690 for the City of Somerset in Pulaski County. The loan proceeds will be used to assist in funding a \$14,897,000 project to upgrade and expand its wastewater treatment plant from 3 MGD to 4.4 MGD, replace sewer lines, and construct a maintenance building. The loan has a 20-year term and a 1.0% interest rate.

The last loan Ms. Williams presented was for \$2,000,000 for the Paducah McCracken Joint Sewer Agency in McCracken County. The funds will be used to make improvements to the Perkins Creek Lift Station. The loan will be combined with other financing for a total of \$3,296,200. The loan has a 20-year term and a 1.0% interest rate.

Representative Wayne asked if KIA is pledging future funds with all five loans and if these loans are approved, how much will be available for new loans in the future. Ms. Williams said the only project that has future funding committed is Sanitation District No. 1. All the other loans are covered by the payments on existing loans, which

KIA currently has in the bank. The safeguard for the SD1 loan is that the loan amount is contingent upon KIA's actual receipt of repayment funds in the amount sufficient to enable KIA to fully fund that loan. Ms. Williams said KIA typically receives about \$23 million in repayment funds every year, and they have had no delinquencies and no defaults. She said next year's repayments are committed to the SD1 loan.

Representative Wayne asked why so much money, over \$43 million, was being committed for the Bowling Green project so far in advance when it has a March 2009 bid date. Ms. Williams said KIA's commitment letters allow for a conditional commitment available for one year for all projects. The March date falls within the one year time frame which is available with every loan.

Representative Wayne asked if pre-approving loans this far in advance may cause project costs to be underestimated. Ms. Williams said KIA did talk to Bowling Green and the City is trying to maximize its funding. Bowling Green has access to capital markets and anticipates addressing financing any cost overruns through them.

Representative Damron asked how much Fund A money will be available for new loans the remainder of this calendar year if these loans are approved. Ms. Williams said next year there will be approximately \$10 million available for clean water state revolving fund borrowers if KIA does not issue leverage bonds.

Representative Damron asked if KIA is spending \$125 million for five borrowers, \$115 million of which is for three loans, that means there is only \$10 million left to the rest of the state. Ms. Williams said the situation is a catch-22. She explained that every year EPA evaluates KIA and looks at the pace of its federal funded programs, and every year KIA has failed to meet the pace required by EPA. This will be the first year in recent history that KIA has actually met and exceeded the required pace. The intent of the program is for environmental clean-up of water. KIA ranks the projects based on which projects will met that goal.

Mr. Covington said over the history of the KIA program, KIA has received criticism from the EPA for not spending the money. Traditionally, the majority of KIA loans have been made to small systems. He said funds have built up in the program until KIA makes these loans to large systems.

In response to a question from Representative Damron, Mr. Covington said in the last year in particular, KIA sent out letters to judges, mayors, water systems and engineering firms informing them of the program and the funds available. KIA funds projects from a priority list developed by the Division of Water. KIA has tried to make people aware that this is another reason the money is going out. He said even though KIA historically has made loans to smaller systems, they are making a concentrated effort to

reach out to larger borrowers in order to eliminate the cash build-up problem in the program.

Representative Damron asked what is the average interest rate paid for KIA loans. Ms. Williams said the average interest rate is slightly over 1%.

Representative Damron commented that if KIA plans to make three loans to larger water systems that have access to capital markets, the low interest loans may not be available to smaller rural water and sewer districts.

Representative Denham congratulated Mr. Covington on his appointment as Executive Director of KIA. He asked what was the current fund balance for the Fund A account. Ms. Williams said KIA had committed all available funds with the exception of about \$20 million.

Representative Denham asked if Fund A money came from the federal government and did the General Assembly make any appropriations. Ms. Williams said KIA is funded through a capitalization grant through the US EPA, and they require that the Commonwealth provide a 20% match. In addition to the capitalization grants and the state match, KIA also receives repayment funds from its existing loans. Ms. Williams said she was not certain how much the General Assembly allowed for Fund A loans the last session. Mr. Hicks added that the 2008 Regular Session, the General Assembly appropriated \$4 million in state bonds in the 2008-10 budget for the state match for KIA Fund A.

In response to another question from Representative Denham, Ms. Williams said that all funds available for the current funding cycle have been committed. She said next year, KIA is projected to receive a FY 2009 capitalization grant. Mr. Hicks said KIA will likely receive approximately \$20 million in federal appropriations in the next funding cycle for Fund A.

Representative Denham asked if there was sufficient demand for the program, could bonds be sold to meet that demand. Ms. Williams said KIA received budgetary authorization to issue leveraged bonds, but some program and process details have to be worked out.

Representative Denham asked how much was the authorization for leveraged bonds. Ms. Williams responded \$200 million for Fund A and \$30 million for Fund F, the drinking water revolving loan fund. Representative Denham asked if this money was committed ahead of time and if there is a demand, would KIA be able to go to the bond market to sell bonds to cover those areas such as the district he represents and other rural districts. Ms. Williams said yes.

Representative Denham asked if KIA had issued this type of bonds in the past. Mr. Covington said this would be the first time KIA has issued leveraged bonds. Mr. Covington added that KIA has been in communication with the Office of Financial Management and the state budget directors' office to discuss these issues.

Representative Rudy asked if there were any consequences from criticism from the federal EPA. Ms. Williams indicated there were no practical repercussions. Representative Rudy said if KIA thinks it has been doing it right all these years, why change because of EPA's criticism. Mr. Covington said realistically speaking, EPA is not going to take the federal funds that have been appropriated by Congress. However, EPA must request funding from Congress for this program and if states have hundreds of millions of dollars in the bank, Congress may not feel it is necessary to appropriate additional funds.

Representative Damron asked who would make the debt service payments if \$200 million of bonds were issued. Mr. Covington said new loans are made from bond proceeds and revenues from existing loans.

Representative Damron asked how KIA is going to issue leveraged bonds since the repayments coming in are used to make new loans. Leveraged bonds would have to be a one-time lump-sum deal because issuers cannot economically go into the capital market in small increments. Mr. Covington said KIA has to demonstrate to EPA that it can maintain the account balances and structure the program so that KIA does not sell bonds greater than the amount that can be supported by the interest income from existing loans alone.

Representative Damron suggested the leveraged bonds are going to yield about 5% such that KIA would need at least \$10 million in interest income each year. With 1% interest rates on the loans, it will take a lot of money to generate the interest income to support the bonds. Kentucky may be thinking it has \$200 million available since that is the authorized amount, but actually it will depend upon the quality and quantity of projects so it may not reach the authorized level.

Mr. Covington said KIA did an analysis of the program's capacity based upon the outstanding loans and it appeared KIA has approximately \$400 million in capacity. KIA is not anticipating using the entire capacity because of the issues Representative Damron mentioned. KIA does not want to encumber the future of the program and it will be conservative in the amount of leveraged bonds they can issue based upon the outstanding loan portfolio. Representative Damron asked Mr. Covington if KIA feels it has enough money coming in from the existing Fund A loan portfolio to continue to meet all of its other obligations and issue \$200 million in new debt. Mr. Covington said yes.

Senator Tori said the Fund A loans being presented today are being committed without the funds on hand. She asked if this would become standard procedure for KIA loans. Mr. Covington said KIA does not plan to commit the entire \$200 million appropriation, but rather \$20 million in loan repayments. Ms. Williams said KIA feels comfortable committing the approximately \$20 million of future repayment funds because those cash flows are very stable. She said they have no reason to think, based on the past 20-year history of the program, that these repayments will not come back. A commitment was made to SD1 only, and SD1 is aware this commitment is based on future repayment funds and is willing to take the chance. Ms. Williams said if these repayments are not available, SD1 has access to and is willing to use capital markets.

Ms. Williams added this was a unique situation. KIA's policy has always been to fund the applications first come, first served. The application for SD1 was the first KIA received this year with Bowling Green's application second. If KIA had funded these two loans, it would have decreased the amount available to the smaller systems. KIA tries also to fund smaller requests. Since the project for SD1 will take about 30 months to complete, KIA's cash flow needs mirror KIA's cash receipts in the future. KIA was trying to tie together their cash flow needs with KIA's cash receipts and free up this year's funding for smaller projects. She said KIA actually did increase the number of loans to smaller systems.

Representative Wayne made a motion to approve the five Fund A loans. The motion was seconded by Representative Damron and approved by unanimous roll call vote.

Representative Damron explained his "Yes" vote. He said he was reluctant to vote yes because this is not a proper use of government money, as it should be used to help those smaller districts. He added that he was concerned that federal EPA money for smaller districts was being utilized for larger districts such as Bowling Green, and the program was established to provide low-cost loans.

Representative Denham explained his "Yes" vote. He said he had a great deal of respect for KIA, but had similar concerns as Representative Damron. He commented that an agency that does not have any loan delinquencies or defaults deserves the Committee's consideration.

Representative Tori explained her "Yes" vote. She said she had reservations about voting to commit funds that are not on hand and this could be dangerous, but the projects are worthy and need to move ahead.

Senator Tori congratulated Mr. Covington on his appointment as Executive Director of KIA.

Ms. Williams next presented various coal/tobacco development grants that were funded through line item appropriations from the General Assembly in 2005 and 2006. No Committee action was required.

Senator Tori next asked Katie Smith, Deputy Commissioner for the Department of Financial Incentives, Cabinet for Economic Development, to report an Economic Development Bond (EDB) grant.

Ms. Smith reported a grant of \$200,000 to the Louisville/Jefferson County Metro Government for the benefit of PharMerica Institutional Pharmacy Services, Inc. Proceeds will be used to offset costs associated with establishing a 61,945 square foot facility that will serve as PharMerica's corporate headquarters.

Representative Denham made a motion to approve the EDB project. The motion was seconded by Representative Wayne and approved by unanimous roll call vote.

Next invited to the table were Tom Howard, Executive Director, Office of Financial Management (OFM), and Terri Fugate, Deputy Executive Director, OFM. Ms. Fugate reported a new bond issue for Morehead State University (MoSU): MoSU General Receipts Bonds, 2008 Series A, (Tax-Exempt) and 2008 Series B (Taxable) for \$12,155,000. Proceeds from this bond issue will be used to refund the university's outstanding 2000 Series N Housing and Dining System Revenue Bonds.

Ms. Fugate said this new bond issue report updates and replaces the bond issue report that was presented to the Committee in March 2008. At that time they were just considering refunding the Series N bonds, but this refunds all of MoSU's outstanding housing system bonds. They do expect to have a positive annual cash flow savings but a net present value loss. Ms. Fugate said MoSU plans to collapse its debt service reserve and its maintenance funds, which will no longer be needed to support the housing and dining system.

Representative Damron made a motion to approve the bond issue. The motion was seconded by Representative Denham and approved by unanimous roll call vote.

The next new bond issue Ms. Fugate reported was University of Kentucky (UK) General Receipts Bonds, 2008 Series A, for \$36,760,000. Proceeds from this bond issue will be used to refund \$37,770,000 outstanding Lexington-Fayette Urban County Government Governmental Project Revenue Refunding Bonds, Series 1998 (UK Alumni Association, Inc. Commonwealth Library Project).

Senator Tori asked which other universities have projects financed by third-party entities that are eligible to refinance the associated debt under the HB 406 budget provision, and what is the total amount per university. Ms. Fugate said she was aware of

several universities that might have a similar type of opportunity. The budget allows for the refunding with general receipts. She said she did not have an outstanding amount for these bond issues. Senator Tori asked Ms. Fugate to furnish this information to the Committee.

Representative Damron said the university is not making any payments on these bonds. Mr. Howard said the repayments are from university private resources that go to support the mission of the institution so when the borrowing costs go down they have more resources available to support the mission.

Representative Damron asked if the rating agencies consider these bonds university debt. Marc Mathews, Treasurer, University of Kentucky, said they do consider this part of the university's consolidated debt. Representative Damron said what was argued when the university did this bond issue several years ago was probably not accurate. The university issued the bonds without General Assembly authorization after the 1994 session. [The project was funded using \$41 million in conduit bonds issued by the Lexington Fayette Urban County Government and almost \$14 million in donor contributions.]

Mr. Mathews said the debt has been viewed as university debt and the Athletic Association was the primary source of repayment for that debt. The savings of this refunding benefits the Athletic Association, which is part of the university.

Representative Damron asked if this project was approved by the UK Board of Regents. Mr. Mathews responded affirmatively. He said the Board also approved a debt policy several years ago that requires them to review debt refunding opportunities every six months. Mr. Mathews added that this bond issue was approved by the Board contingent upon certain net present value savings being achieved by the sale date.

In response to additional questions from Representative Damron, Mr. Mathews said the Athletic Association makes payments on the bonds, and any savings associated with this refinancing will go to the Athletic Association. He added that there is a secondary guarantee if the Athletic Association were ever unable to make the payment. Mr. Mathews said he did not know what the Athletic Association will use the funds for, but they would clear any use of the funds through the Board of Trustees. He explained that the Athletic Association, even though it is a separate 501(c)(3) corporation, is an affiliated corporation of the university, and they cannot expend funds without the approval of the Board of Trustees.

Representative Damron asked if by going through this process, more debt was not being created and impairing potential borrowing capacity of the university. Mr. Mathews said this refinancing would not create additional debt. This action will free up the debt service reserve, there will be less bonds outstanding and more capacity as a result.

Representative Wayne made a motion to approve the bond issue. The motion was seconded by Representative Damron and approved by unanimous roll call vote.

Ms. Fugate next reported a new bond issue, Northern Kentucky University General Receipts Bonds, 2008 Series A, for \$19,475,000. Proceeds from this bond issue will be used to reimburse the university for its purchase and renovation of the former Lakeside Nursing Center, now the James P. Callahan Residence Hall.

Representative Wayne made a motion to approve the bond issue. The motion was seconded by Representative Rudy and approved by unanimous roll call vote.

The next bond issue was for the Kentucky Economic Development Finance Authority (KEDFA) Healthcare System Revenue Bonds, Series 2008 (Kentucky Easter Seal Society, d/b/a Cardinal Hill Healthcare System Project), \$43,000,000. Proceeds from this bond issue will be used to provide funds for an addition to the Cardinal Hill Rehabilitation Hospital in Lexington and refund outstanding variable rate debt.

Representative Denham asked about the status of the KEDFA program, and the remaining balance of the KEDFA pooled loan program. Ms. Smith said these funds were from conduit financing under the 1985 KEDFA Hospital Bond Pool Program. The outstanding balance was approximately \$13 million, and would decrease to \$10 million if this bond issue is approved.

Mr. Howard added there are a limited number of participants remaining in that pool. Cardinal Hill and other borrowers are refinancing their loans in order to lower their cost of capital. When all participants have refinanced their KEDFA loans, the pool will essentially cease to exist. Borrowers are looking to refinance out of the pool because the credit facility provider, FGIC (Federal Guaranty Insurance Company), has been downgraded below investment grade for some rating services but remains Baa3 by Moody's. If Moody's drops FGIC below investment grade rating, the pool will essentially collapse and become bank term loans which will carry, depending upon the borrower, a higher rate than they can get in the capital market.

Representative Denham asked Mr. Howard if Cardinal Hill was arranging private financing in order to move out of the pool. Mr. Howard responded affirmatively and said many health care providers are using KEDFA as a conduit. Representative Denham asked if this should increase the funds back into the KEDFA bond pool.

Ms. Smith said the KEDFA pool provided private financing. Mr. Howard said those proceeds would be used to pay off existing notes and there would be a decrease instead of an increase in the amount of bonds outstanding. All private borrowers are refinancing their loans.

Representative Damron made a motion to approve the bond issue. The motion was seconded by Representative Denham and approved by unanimous roll call vote.

The last new bond issue reported was for the Kentucky Asset/Liability Commission General Fund Tax and Revenue Anticipation Notes (TRANs), 2008 Series A, \$600,000,000. Proceeds from this issue will finance Fiscal Year 2009 General Fund cash flow requirements in anticipation of taxes and revenues to be collected during the fiscal year.

Ms. Fugate said the bond issue is for \$507,724,550 and the OFM resolution allows for issuance of up to \$600,000,000. It is likely that once the full analysis has been completed, OFM will issue between \$250,000,000 and \$450,000,000, depending on General Fund cash needs. No action was required by the Committee.

Next Ms. Fugate presented a follow-up report for a previously approved bond issue for Kentucky Housing Corporation (KHC) Revenue Bonds, 2008 Series A (AMT) and Series B (Taxable) (Variable Rate), \$49,270,000. This bond issue was approved at a previous Committee meeting, and no further action was required.

Mr. Howard discussed Kentucky's revised ratings outlooks with the Committee. He said Moody's and Fitch changed the state's outlook from stable to negative. They both cite economic conditions, the budget's structural imbalance, and the drawdown of reserves as the reasons for the revising of the state's outlook. Standard and Poor's (S&P) maintained Kentucky's outlook as positive but S&P rates the state the lowest of the three rating agencies.

Senator Tori asked Mr. Howard if he agreed that the economic situation impacted ratings. Mr. Howard said certainly economic conditions affect state budgets. There are four other states on negative outlook with Moody's. Fitch has four states on negative outlook and two on credit watch - negative with potential downgrades. S&P does not have any states on negative outlook at the present time but their rating scale is more conservative than the other two rating agencies. The municipal sector is under stress, and budgets will be difficult as revenues are struggling in this current economic climate.

Representative Denham asked Mr. Howard how many basis points and how much additional dollars in debt is this going to cost the Commonwealth. Mr. Howard said an outlook does not change the rating. If the outlook were to continue to decline and the state was downgraded to the single A level, using current benchmark scale, that cost could be on an un-enhanced basis if we were not able to purchase bond insurance because of all the other issues of subprime and the limited amount of bond insurance available. The cost in today's market could be a 1/3 of a percent higher. On the existing debt that is

authorized but not yet issued, it would theoretically cost about \$58 million over the life of the bonds.

Representative Denham asked Mr. Howard how many bonds were going to be refinanced in the near term that this would adversely affect. Mr. Howard said he did not see any potential refundings at this time. The tender that was attempted for State Property and Buildings Commission No. 89 was not able to materialize due to changing market conditions. OFM will be financing authorized but unissued debt from the 2005 and the 2006 Regular Sessions, which remains at just under \$1 billion and the new authorization. Representative Denham asked if there was anything that could be done to head-off a downgrade. Mr. Howard said that the consistent message is the rebuilding of reserves. Budget reserves, called rainy day funds, cushion a state during the downturn. For example, in February 2007, rating agencies revised the state's issuer credit rating to a positive outlook citing the increased Budget Reserve Trust Fund balance.

Next, Ms. Fugate presented seven new school bond issues with School Facilities Construction Commission (SFCC) debt service participation: Bowling Green Independent (Warren County), Campbellsville Independent (Taylor County), Carlisle County, Fleming County, Hardin County, Harrison County, and Owensboro Independent (Daviess County).

Representative Wayne made a motion to approve the school bond issues. The motion was seconded by Representative Damron and approved by unanimous roll call vote.

Next, Ms. Osborne reported two locally-funded school bond issues submitted to the Committee for review this month for Ft. Thomas Independent (Campbell County) and Harrison County. She said all disclosure information has been filed, and no further action on the bond issues was required.

Senator Tori said she wanted to note for the record that on Sunday, May 11, Cumberland Falls State Park was stuck by a tornado, which was confirmed to have winds over 100 miles per hour by the National Weather Service. She said there was damage to trees and vehicles but luckily there were no injuries or fatalities to park visitors or employees.

Senator Tori said the Committee's next meeting is tentatively scheduled for June 17, 2008, in the Capitol Annex Building. With there being no further business the meeting adjourned at 2:45 p.m.